

investing controlled foreign corporation.

(f) *Effective/applicability date.* Paragraph (e)(5) of this section applies to investments made on or after June 14, 1988.

[T.D. 8209, 53 FR 22171, June 14, 1988, as amended at T.D. 9402, 73 FR 35582, June 24, 2008; T.D. 9630, 76 FR 36995, June 24, 2011]

§ 1.956-2 Definition of United States property.

(a) *Included property*—(1) *In general.* For purposes of section 956(a) and § 1.956-1, United States property is (except as provided in paragraph (b) of this section) any property acquired (within the meaning of paragraph (d)(1) of this section) by a foreign corporation (whether or not a controlled foreign corporation at the time) during any taxable year of such foreign corporation beginning after December 31, 1962, which is—

(i) Tangible property (real or personal) located in the United States;

(ii) Stock of a domestic corporation;

(iii) An obligation (as defined in paragraph (d)(2) of this section) of a United States person (as defined in section 957(d)); or

(iv) Any right to the use in the United States of—

(a) A patent or copyright,

(b) An invention, model, or design (whether or not patented),

(c) A secret formula or process, or

(d) Any other similar property right, which is acquired or developed by the foreign corporation for use in the United States by any person. Whether a right described in this subdivision has been acquired or developed for use in the United States by any person is to be determined from all the facts and circumstances of each case. As a general rule, a right actually used principally in the United States will be considered to have been acquired or developed for use in the United States in the absence of affirmative evidence showing that the right was not so acquired or developed for such use.

(2) *Illustrations.* The application of the provisions of this paragraph may be illustrated by the following examples:

Example 1. Foreign corporation R uses as a taxable year a fiscal year ending on June 30.

Corporation R acquires on June 1, 1963, and holds on June 30, 1963, \$100,000 of tangible property (not described in section 956(b)(2)) located in the United States. Corporation R's aggregate investment in United States property at the close of its taxable year ending June 30, 1963, is zero since the property which is acquired on June 1, 1963, is not acquired during a taxable year of R Corporation beginning after December 31, 1962. Assuming no change in R Corporation's aggregate investment in United States property during its taxable year ending June 30, 1964, R Corporation's increase in earnings invested in United States property for such taxable year is zero.

Example 2. Foreign corporation S uses the calendar year as a taxable year and is a controlled foreign corporation for its entire taxable year 1965. Corporation S is not a controlled foreign corporation at any time during its taxable years 1963 and 1964. Corporation S owns on December 31, 1964, \$100,000 of tangible property (not described in section 956(b)(2)) located in the United States which it acquires during taxable years beginning after December 31, 1962. Corporation S's aggregate investment in United States property on December 31, 1964, is \$100,000. Corporation S's current and accumulated earnings and profits (determined as provided in paragraph (b) of § 1.956-1) as of December 31, 1964, are in excess of \$100,000. Assuming no change in S Corporation's aggregate investment in United States property during its taxable year 1965, S Corporation's increase in earnings invested in United States property for such taxable year is zero.

Example 3. Foreign corporation T uses the calendar year as a taxable year and is a controlled foreign corporation for its entire taxable years 1963, 1964, and 1966. At December 31, 1964, T Corporation's investment in United States property is \$100,000. Corporation T is not a controlled foreign corporation at any time during its taxable year 1965 in which it acquires \$25,000 of tangible property (not described in section 956(b)(2)) located in the United States. On December 31, 1965, T Corporation holds the United States property of \$100,000 which it held on December 31, 1964, and, in addition, the United States property acquired in 1965. Corporation T's aggregate investment in United States property at December 31, 1965, is \$125,000. Corporation T's current and accumulated earnings and profits (determined as provided in paragraph (b) of § 1.956-1) as of December 31, 1965, are in excess of \$125,000, and T Corporation pays no amount during 1965 to which section 959 (c)(1) applies. Assuming no change in T Corporation's aggregate investment in United States property during its taxable year 1966, T Corporation's increase in earnings invested in United States property for such taxable year is zero.

(3) *Property owned through partnership.* For purposes of section 956, if a controlled foreign corporation is a partner in a partnership that owns property that would be United States property, within the meaning of paragraph (a)(1) of this section, if owned directly by the controlled foreign corporation, the controlled foreign corporation will be treated as holding an interest in the property equal to its interest in the partnership and such interest will be treated as an interest in United States property. This paragraph (a)(3) applies to taxable years of a controlled foreign corporation beginning on or after July 23, 2002.

(b) *Exceptions—(1) Excluded property.* For purposes of section 956(a) and paragraph (a) of this section, United States property does not include the following types of property held by a foreign corporation:

(i) Obligations of the United States.

(ii) Money.

(iii) Deposits with persons carrying on the banking business, unless the deposits serve directly or indirectly as a pledge or guarantee within the meaning of paragraph (c) of this section. See paragraph (e)(2) of § 1.956-1.

(iv) Property located in the United States which is purchased in the United States for export to, or use in, foreign countries. For purposes of this subdivision, property to be used outside the United States will be considered property to be used in a foreign country. Whether property is of a type described in this subdivision is to be determined from all the facts and circumstances in each case. Property which constitutes export trade assets within the meaning of section 971(c)(2) and paragraph (c)(3) of § 1.971-1 will be considered property of a type described in this subdivision.

(v) Any obligation (as defined in paragraph (d)(2) of this section) of a United States person (as defined in section 957(d)) arising in connection with the sale or processing of property if the amount of such obligation outstanding at any time during the taxable year of the foreign corporation does not exceed an amount which is ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United

States person, or, if the sale or processing transaction occurs between related persons, would be ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person if such persons were unrelated persons. Whether the amount of an obligation described in this subdivision is ordinary and necessary is to be determined from all the facts and circumstances in each case.

(vi) Any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States. Whether transportation property described in this paragraph (b)(1)(vi) is used in foreign commerce and predominantly outside the United States is to be determined from all the facts and circumstances of each case. As a general rule, such transportation property will be considered to be used predominantly outside the United States if 70 percent or more of the miles traversed (during the taxable year at the close of which a determination is made under section 956(a)(2)) in the use of such property are traversed outside the United States or if such property is located outside the United States 70 percent of the time during such taxable year. Notwithstanding the above, an aircraft or vessel, including component parts, is excluded from United States property if the aircraft or vessel is leased in foreign commerce (as the term is defined in § 1.954-2(c)(2)(v)) and rents derived from leasing such aircraft or vessel are excluded from foreign personal holding company income under section 954(c)(2)(A).

(vii) An amount of assets described in paragraph (a) of this section of an insurance company equivalent to the unearned premiums or reserves which are ordinary and necessary for the proper conduct of that part of its insurance business which is attributable to contracts other than those described in section 953(a)(1) and the regulations thereunder. For purposes of this subdivision, a reserve will be considered ordinary and necessary for the proper conduct of an insurance business if, under the principles of paragraph (c) of § 1.953-4, such reserve would qualify as

a reserve required by law. See paragraph (d)(3) of § 1.954-2 for determining, for purposes of this subdivision, the meaning of insurance company and of unearned premiums.

(viii) For taxable years beginning after December 31, 1975, the voting or nonvoting stock or obligations of an unrelated domestic corporation. For purposes of this subdivision, an unrelated domestic corporation is a domestic corporation which is neither a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation making the investment, nor a corporation 25 percent or more of whose total combined voting power of all classes of stock entitled to vote is owned or considered as owned (within the meaning of section 958 (b)) by United States shareholders of the controlled foreign corporation making the investment. The determination of whether a domestic corporation is an unrelated corporation is made immediately after each acquisition of stock or obligations by the controlled foreign corporations.

(ix) For taxable years beginning after December 31, 1975, movable drilling rigs or barges and other movable exploration and exploitation equipment (other than a vessel or an aircraft) when used on the Continental Shelf (as defined in section 638) of the United States in the exploration for, development, removal, or transportation of natural resources from or under ocean waters. Property used on the Continental Shelf includes property located in the United States which is being constructed or is in storage or in transit within the United States for use on the Continental Shelf. In general, the type of property which qualifies for the exception under this subdivision includes any movable property which would be entitled to the investment credit if used outside the United States in certain geographical areas of the Western Hemisphere pursuant to section 48(a)(2)(B)(x) (without reference to sections 49 and 50).

(x) An amount of—

(a) A controlled foreign corporation's assets described in paragraph (a) of this section equivalent to its earnings and profits which are accumulated after December 31, 1962, and are attributable

to items of income described in section 952(b) and the regulations thereunder, reduced by the amount of

(b) The earnings and profits of such corporation which are applied in a taxable year of such corporation beginning after December 31, 1962, to discharge a liability on property, but only if the liability was in existence at the close of such corporation's taxable year immediately preceding its first taxable year beginning after December 31, 1962, and the property would have been United States property if it had been acquired by such corporation immediately before such discharge.

For purposes of this subdivision, distributions made by such corporation for any taxable year shall be considered first made out of earnings and profits for such year other than earnings and profits referred to in (a) of this subdivision.

(xi) [Reserved] For further guidance, see § 1.956-2T(b)(1)(xi).

(2) *Statement required.* If a United States shareholder of a controlled foreign corporation excludes any property from the United States property of such controlled foreign corporation on the ground that section 956(b)(2) applies to such excluded property, he shall attach to his return a statement setting forth, by categories described in paragraph (a)(1) of this section, the amount of United States property of the controlled foreign corporation and, by categories described in subparagraph (1) of this paragraph, the amount of such property which is excluded.

(c) *Treatment of pledges and guarantees*—(1) *General rule.* Except as provided in subparagraph (4) of this paragraph, any obligation (as defined in paragraph (d)(2) of this section) of a United States person (as defined in section 957(d)) with respect to which a controlled foreign corporation is a pledgor or guarantor shall be considered for purposes of section 956(a) and paragraph (a) of this section to be United States property held by such controlled foreign corporation.

(2) *Indirect pledge or guarantee.* If the assets of a controlled foreign corporation serve at any time, even though indirectly, as security for the performance of an obligation of a United States person, then, for purposes of

paragraph (c)(1) of this section, the controlled foreign corporation will be considered a pledgor or guarantor of that obligation. For this purpose the pledge of stock of a controlled foreign corporation will be considered as the indirect pledge of the assets of the corporation if at least 66⅔ percent of the total combined voting power of all classes of stock entitled to vote is pledged and if the pledge of stock is accompanied by one or more negative covenants or similar restrictions on the shareholder effectively limiting the corporation's discretion with respect to the disposition of assets and the incurrence of liabilities other than in the ordinary course of business. This paragraph (c)(2) applies only to pledges and guarantees which are made after September 8, 1980. For purposes of this paragraph (c)(2) a refinancing shall be considered as a new pledge or guarantee.

(3) *Illustrations.* The following examples illustrate the application of this paragraph (c):

Example 1. A, a United States person, borrows \$100,000 from a bank in foreign country X on December 31, 1964. On the same date controlled foreign corporation R pledges its assets as security for A's performance of A's obligation to repay such loan. The place at which or manner in which A uses the money is not material. For purposes of paragraph (b) of § 1.956-1, R Corporation will be considered to hold A's obligation to repay the bank \$100,000, and, under the provisions of paragraph (e)(2) of § 1.956-1, the amount taken into account in computing R Corporation's aggregate investment in United States property on December 31, 1964, is the unpaid principal amount of the obligation on that date (\$100,000).

Example 2. The facts are the same as in example 1, except that R Corporation participates in the transaction, not by pledging its assets as security for A's performance of A's obligation to repay the loan, but by agreeing to buy for \$1,000,000 at maturity the note representing A's obligation if A does not repay the loan. Separate arrangements are made with respect to the payment of the interest on the loan. The agreement of R Corporation to buy the note constitutes a guarantee of A's obligation. For purposes of paragraph (b) of § 1.956-1, R Corporation will be considered to hold A's obligation to repay the bank \$100,000, and, under the provisions of paragraph (e)(2) of § 1.956-1, the amount taken into account in computing R Corporation's aggregate investment in United States property on December 31, 1964, is the unpaid prin-

cipal amount of the obligation on that date (\$100,000).

Example 3. A, a United States person, borrows \$100,000 from a bank on December 10, 1981, pledging 70 percent of the stock of X, a controlled foreign corporation, as collateral for the loan. A and X use the calendar year as their taxable year. In the loan agreement, among other things, A agrees not to cause or permit X Corporation to do any of the following without the consent of the bank:

(a) Borrow money or pledge assets, except as to borrowings in the ordinary course of business of X Corporation;

(b) Guarantee, assume, or become liable on the obligation of another, or invest in or lend funds to another;

(c) Merge or consolidate with any other corporation or transfer shares of any controlled subsidiary;

(d) Sell or lease (other than in the ordinary course of business) or otherwise dispose of any substantial part of its assets;

(e) Pay or secure any debt owing by X Corporation to A; and

(f) Pay any dividends, except in such amounts as may be required to make interest or principal payments on A's loan from the bank.

A retains the right to vote the stock unless a default occurs by A. Under paragraph (c)(2) of this section, the assets of X Corporation serve indirectly as security for A's performance of A's obligation to repay the loan and X Corporation will be considered a pledgor or guarantor with respect to that obligation. For purposes of paragraph (b) of § 1.956-1, X Corporation will be considered to hold A's obligation to repay the bank \$100,000 and under paragraph (e)(2) of § 1.956-1, the amount taken into account in computing X Corporation's aggregate investment in United States property on December 31, 1981, is the unpaid principal amount of the obligation on that date.

(4) *Special rule for certain conduit financing arrangements.* The rule contained in subparagraph (1) of this paragraph shall not apply to a pledge or a guarantee by a controlled foreign corporation to secure the obligation of a United States person if such United States person is a mere conduit in a financing arrangement. Whether the United States person is a mere conduit in a financing arrangement will depend upon all the facts and circumstances in each case. A United States person will be considered a mere conduit in a financing arrangement in a case in which a controlled foreign corporation pledges stock of its subsidiary corporation, which is also a controlled foreign corporation, to secure the obligation of

such United States person, where the following conditions are satisfied:

(i) Such United States person is a domestic corporation which is not engaged in the active conduct of a trade or business and has no substantial assets other than those arising out of its relending of the funds borrowed by it on such obligation to the controlled foreign corporation whose stock is pledged; and

(ii) The assets of such United States person are at all times substantially offset by its obligation to the lender.

(d) *Definitions*—(1) *Meaning of “acquired”*—(i) *Applicable rules*. For purposes of this section—

(a) Property shall be considered acquired by a foreign corporation when such corporation acquires an adjusted basis in the property;

(b) Property which is an obligation of a United States person with respect to which a controlled foreign corporation is a pledgor or guarantor (within the meaning of paragraph (c) of this section) shall be considered acquired when the corporation becomes liable as a pledgor or guarantor or is otherwise considered a pledgor or guarantor (within the meaning of paragraph (c)(2) of this section); and

(c) Property shall not be considered acquired by a foreign corporation if—

(1) Such property is acquired in a transaction in which gain or loss would not be recognized under this chapter to such corporation if such corporation were a domestic corporation;

(2) The basis of the property acquired by the foreign corporation is the same as the basis of the property exchanged by such corporation; and

(3) The property exchanged by the foreign corporation was not United States property (as defined in paragraph (a)(1) of this section) but would have been such property if it had been acquired by such corporation immediately before such exchange.

(ii) *Illustrations*. The application of this subparagraph may be illustrated by the following examples:

Example 1. Foreign corporation R uses the calendar year as a taxable year and acquires before January 1, 1963, stock of domestic corporation M having as to R Corporation an adjusted basis of \$10,000. The stock of M Corporation is not United States property of R Corporation on December 31, 1962, since it is

not acquired in a taxable year of R Corporation beginning on or after January 1, 1963. On June 30, 1963, R Corporation sells the M Corporation stock for \$15,000 in cash and expends such amount in acquiring stock of domestic corporation N which has as to R Corporation an adjusted basis of \$15,000. For purposes of determining R Corporation's aggregate investment in United States property on December 31, 1963, R Corporation has, by virtue of acquiring the stock of N Corporation, acquired \$15,000 of United States property.

Example 2. Foreign corporation S, a controlled foreign corporation for the entire period here involved, uses the calendar year as a taxable year and purchases for \$100,000 on December 31, 1963, tangible property (not described in section 956(b)(2)) located in the United States and having a remaining estimated useful life of 10 years, subject to a mortgage of \$80,000 payable in 5 annual installments. The property constitutes United States property as of December 31, 1963, and the amount taken into account for purposes of determining the aggregate amount of S Corporation's investment in United States property under paragraph (b) of § 1.956-1 is \$20,000. No depreciation is sustained with respect to the property during the taxable year 1963. During the taxable year 1964, S Corporation pays \$16,000 on the mortgage and sustains \$10,000 of depreciation with respect to the property. As of December 31, 1964, the amount taken into account with respect to the property for purposes of determining the aggregate amount of S Corporation's investment in United States property under paragraph (b) of § 1.956-1 is \$26,000, computed as follows:

Cost of property	\$100,000
Less: Reserve for depreciation	10,000
Adjusted basis of property	90,000
Less: Liability to which property is subject:	
Gross amount of mortgage ...	\$80,000
Payment during 1964	16,000
	64,000
Amount taken into account (12-31-64)	26,000

Example 3. Controlled foreign corporation T uses the calendar year as a taxable year and acquires on December 31, 1963, \$10,000 of United States property not described in section 956(b)(2); no depreciation is sustained with respect to the property during 1963. Corporation T's current and accumulated earnings and profits (determined as provided in paragraph (b) of § 1.956-1) as of December 31, 1963, are in excess of \$10,000, and T Corporation's United States shareholders include in their gross income under section 951(a)(1)(B) their pro rata share of T Corporation's increase (\$10,000) for 1963 in earnings invested in United States property. On January 1, 1964, T Corporation acquires an additional

\$10,000 of United States property not described in section 956(b)(2). Each of the two items of property has an estimated useful life of 5 years, and T Corporation sustains \$4,000 of depreciation with respect to such properties during its taxable year 1964. Corporation T's current and accumulated earnings and profits as of December 31, 1964, exceed \$16,000, determined as provided in paragraph (b) of § 1.956-1. Corporation T pays no amounts during 1963 to which section 959(c)(1) applies. Corporation T's investment of earnings in United States property at December 31, 1964, is \$16,000, and its increase for 1964 in earnings invested in United States property is \$6,000.

Example 4. Foreign corporation U uses the calendar year as a taxable year and acquires before January 1, 1963, stock in domestic corporation M having as to U Corporation an adjusted basis of \$10,000. On December 1, 1964, pursuant to a statutory merger described in section 368(a)(1), M Corporation merges into domestic corporation N, and U Corporation receives on such date one share of stock in N Corporation, the surviving corporation, for each share of stock it held in M Corporation. Pursuant to section 354 no gain or loss is recognized to U Corporation, and pursuant to section 358 the basis of the property received (stock of N Corporation) is the same as that of the property exchanged (stock of M Corporation). Corporation U is not considered for purposes of section 956 to have acquired United States property by reason of its receipt of the stock in N Corporation.

Example 5. The facts are the same as in example 4, except that U Corporation acquires the stock of M Corporation on February 1, 1963, rather than before January 1, 1963. For purposes of determining U Corporation's aggregate investment in United States property on December 31, 1963, U Corporation has, by virtue of acquiring the stock of M Corporation, acquired \$10,000 of United States property. Corporation U pays no amount during 1963 to which section 959(c)(1) applies. The reorganization and resulting acquisition on December 1, 1964, by U Corporation of N Corporation's stock also represents an acquisition of United States property; however, assuming no other change in U Corporation's aggregate investment in United States property during 1964, U Corporation's increase for such year in earnings invested in United States property is zero.

(2) [Reserved]

(e) *Effective/applicability date.* The last sentence of paragraph (b)(1)(vi) of this section applies to taxable years of controlled foreign corporations beginning on or after May 2, 2006, and for taxable years of United States shareholders with or within which such taxable years of the controlled foreign corpora-

tions end. Taxpayers may elect to apply the rule of the last sentence of paragraph (b)(1)(vi) of this section to taxable years of controlled foreign corporations beginning after December 31, 2004, and for taxable years of United States shareholders with or within which such taxable years of the controlled foreign corporations end. If an election is made to apply the last two sentences of § 1.954-2(c)(2)(ii) and § 1.954-2(c)(2)(v) through (vii) to taxable years of a controlled foreign corporation beginning after December 31, 2004, then the election must also be made for the last sentence of paragraph (b)(1)(vi) of this section.

(Secs. 956(c), 7805, Internal Revenue Code of 1954 (76 Stat. 1017, 68A Stat. 917; 26 U.S.C. 956(c) and 7805 respectively)))

[T.D. 6704, 29 FR 2601, Feb. 20, 1964, as amended by T.D. 7712, 45 FR 52374, Aug. 7, 1980; T.D. 7797, 46 FR 57675, Nov. 25, 1981; T.D. 8209, 53 FR 22171, June 14, 1988; T.D. 9008, 67 FR 48025, July 23, 2002; T.D. 9406, 73 FR 38117, July 3, 2008; T.D. 9525, 76 FR 26181, May 6, 2011; T.D. 9589, 77 FR 27614, May 11, 2012]

§ 1.956-2T Definition of United States Property (temporary).

(a) through (b)(1)(x) [Reserved] For further guidance, see § 1.956-2(a) through (b)(1)(x).

(xi) An obligation of a United States person arising from an upfront payment by a controlled foreign corporation (within the meaning of section 957(a)) with respect to a notional principal contract (within the meaning of § 1.446-3(c)(1)) where the following conditions are satisfied—

(A) The controlled foreign corporation that makes the upfront payment is a dealer in securities or commodities (within the meaning of section 475(c)(1) or (e)(1));

(B) The upfront payment is required under a contract that is cleared by a derivatives clearing organization (as such term is defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a)) or a clearing agency (as such term is defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)) that is registered as a derivatives clearing organization under the Commodity Exchange Act or as a clearing agency under the Securities Exchange Act of 1934, respectively;